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Employment Pitfall

Worker Misclassification May Bring Penalties

BY KENNETH M. BLOCK AND ANDREW W. SINGER

Kenneth M. Block

Andrew W. Singer

CONSTRUCTION LAW

Companies that retain labor at construction sites must be cautious to avoid the many pitfalls of worker misclassification, that is, characterizing employees as "independent contractors." In the exceedingly competitive construction industry—where many workers are utilized only temporarily—employers have powerful economic incentives to label workers as independent contractors, including savings on payroll taxes and workers' compensation premiums. Unsurprisingly, a 2007 study by Cornell University found that worker misclassification in New York state is more prevalent in the construction industry than any other industry examined and exists at a rate of 15 percent.[1]

The Problem

Federal, state and local governments have taken note of the problem of misclassification. Senators Obama, Durbin, Kennedy, Clinton, Boxer, Mikulski and Murray have introduced a bill entitled the Independent Contractor Proper Classification Act. Among other things, the bill would deny employers the ability to use industry practice in classifying workers and would allow workers to request a determination of status directly from the IRS.

In New York state, on Sept. 5, 2007, then Governor Spitzer signed into law an executive order which established a Joint Enforcement task force for combating employee misclassification. The executive order cited as the basis for its implementation employers' "attempt to avoid the...legal obligations under the federal and state labor, employment and tax laws, including laws governing minimum wage, overtime, prevailing wage, unemployment insurance, workers' compensation insurance, temporary disability insurance, wage payment and income tax...." The task force is led by the New York Department of Labor and integrates the coordinated efforts of the Attorney General's Office, the Department of Taxation and Finance, the New York City Comptroller's Office, the Workers' Compensation Board and the Workers' Compensation Inspector General's Office, among other agencies. In its Feb. 1, 2008 report, the task force stated it had already conducted work site sweeps targeting over one hundred employers. The sweeps resulted in the reclassification of thousands of workers as well as hundreds of thousands of dollars worth of penalties. Notably, the task force focused enforcement efforts on the construction industry.[2]

With respect to wage and hour laws, worker misclassification can lead to violations of the Fair Labor Standards Act (FLSA) and the New York Labor Law in the context of overtime compensation. Both the FLSA and the New York Labor Law generally require that an employer pay non-exempt employees at a rate of 1.5 times the employee's regular rate for all hours over 40 worked in a single work week.[3] Employees labeled "independent contractors" may bring an action to recover unpaid overtime compensation and seek compensatory, as well as liquidated, damages. A federal criminal action may be brought against an employer who "willfully" misclassifies workers thereby avoiding overtime payments.[4] The Second Circuit has held that a violation is willful if the employer shows reckless disregard for the provisions of the FLSA.[5] Given that courts construe FLSA definitions liberally and in light of the remedial purposes of the legislation, construction companies must carefully examine the actual status of workers before denying overtime compensation.

Misclassification may also violate the Employee Retirement Income Security Act of 1974 ("ERISA") by depriving workers of benefits to which they otherwise would have been entitled.[6] Under ERISA, retirement plan fiduciaries have the responsibility to ensure that beneficiaries are accurately identified. In addition to the remedies available to misclassified workers themselves, the U.S. Department of Labor is empowered to bring a civil action for breach of fiduciary duty and has done so in the context of misclassified "independent contractors."[7]

In the context of workers injured on the job, employers of individuals misclassified as independent contractors may be unexpectedly exposed to liability for personal injury or violations of the labor law. Employers owe a duty of care to employees, and under OSHA employers have a duty to provide a workplace free from recognized hazards to employees at construction sites. New York courts have held that the term "employee" should be interpreted broadly in these contexts. As such, courts have allowed personal injury suits by individuals against entities notwithstanding that the entity paid the individual as an

Kenneth M. Block *and* **Andrew W. Singer** *are members of Tannenbaum Helpern Syracuse & Hirschtritt LLP.* **Stacey Usiak** *and* **Jason Klimpl** *participated in the preparation of this article.*

independent contractor by issuing a Form 1099 and not withholding taxes.[8] Employers may risk liability for their workers' personal injuries unless a "compellingly clear" record establishes independent status.[9] Moreover, construction employers must be aware that certain sections of the New York Labor Law impose liability on employers even for the injuries of independent contractors.[10] Accordingly, employers cannot shield their liability from personal injuries on unsafe job sites by merely labeling workers as independent contractors.

Worker injuries also implicate claims for workers' compensation. A brief look at New York workers' compensation case law reveals a long history of misclassified construction workers.[11] In addition to penalties and fines for misclassification, an employer's failure to properly comply with the workers' compensation laws could result in criminal charges.[12] Similarly, the New York Unemployment Insurance Appeal Board has found employers liable for additional unemployment insurance contributions where workers were misclassified.[13]

Employers will also be held accountable for their failure to properly withhold various taxes, such as those for Social Security and income, from amounts paid to independent contractors. The IRS has the power to assess a deficiency and other penalties against employers who wrongly treat their employees as independent contractors. Employers misclassifying workers as independent contractors may be indicted for evading taxes and for filing false and fraudulent tax returns that understate the amount of taxable wages paid.[14] Misclassifying workers can also result in liability under other federal laws, including Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, the National Labor Relations Act and the Family and Medical Leave Act.

Status Determination

Unfortunately, there is no bright-line test for practitioners or employers to use in determining whether a worker is an independent contractor and there is no single factor that is controlling. Rather, the determination turns on the relevant statute and the jurisdiction.

One commonly applied test is the "right to control" which focuses on the employer's right to direct the worker in the performance of his or her duties. That is, "whether an individual is an employee or an independent contractor turns principally upon the question of who exercises control over the method and means of the work."[15] In construction cases, courts have held additional factors to consider are whether the individual provides his or her own equipment, how payment is made (i.e., by the job or lump sum) and whether taxes are withheld.[16] Thus, where the worker has no right to set his or her hours, may be discharged and performs unskilled labor, the worker will likely be found to be an employee.[17] However, the mere fact that a worker is required to follow general plans furnished by a construction contractor will not destroy his or her independent status if the other factors are met.[18] Conversely, where a construction company refers in writing to a worker it had classified as an independent contractor, as its "employee" and offers a worker a "permanent position" at a flat rate per hour, a court will likely disregard the independent contractor status asserted by the company.[19] Construction companies must be cognizant of the fact that courts will disregard a written agreement between a company and a worker which purports to classify the worker as an independent contractor where the worker is more properly classified as an employee.[20]

Rather than intentionally or haphazardly mislabeling workers for short-term profits, construction companies must consider the myriad liabilities and sanctions potentially applicable in such instances.

Joint Employment

Even where a worker is properly classified as the employee of another company—such as in the context of subcontractors—the doctrine of "joint employment" could render an employer liable for the employment law violations of a separate business. That is, "[w]here this doctrine is operative, an employee formally employed by one entity, who has been assigned to work in circumstances that justify the conclusion that the employee is at the same time constructively employed by another entity, may impose liability for violations of employment law on the constructive employer, on the theory that this other entity is the employee's joint employer."[21] Specifically, a "joint employer" analysis would consider the commonality of hiring, firing, discipline, pay, insurance records and supervision.

In one such case, a construction company contracted with a marketing firm that provided on-site sales services. When an employee of the marketing firm was subjected to sexual harassment by construction company employees, the harassed employee brought a Title VII action against the construction company on the grounds that such entity was her "joint employer." The Second Circuit reiterated the applicability of the doctrine of joint employment, although it dismissed the claim.[22] The doctrine has also been used against unwary companies in the enforcement of other laws, including the NLRA, FLSA, the New York Labor Law and workers' compensation law, to name a few. Consequently, each "employer" in a joint employment situation must be wary of the employment policies and procedures of the other company involved to ensure full compliance with applicable employment laws.

Conclusion

Studies have found that the construction industry has the highest incidence of misclassification of employees as independent contractors. Rather than intentionally or haphazardly mislabeling workers for short-term profits, construction companies must consider the myriad liabilities and sanctions potentially applicable in such instances. With the growing tendency of the government and workers themselves to seek recourse against employers who misclassify for their own gain, a proper status determination of all individuals performing services is as important as ever.

1 Donahue, Lamare, & Kotler, The Cost of Worker Misclassification in New York State, Cornell University (ILR Collection 2007).
2 See Report of the Joint Enforcement task force on Employee Misclassification, New York State Department of Labor (Feb. 2008).
3 29 U.S.C. § 207(a)(1); 12 N.Y.C.R.R. 142-2.2.
4 29 U.S.C. § 216(a).
5 Lee v. ABC Carpet & Home, 236 F.R.D. 193, n.4 (S.D.N.Y. 2006).
6 29 U.S.C. § 1001 et seq.
7 Herman v. Time Warner Inc., 56 F. Supp. 2d 411 (S.D.N.Y. 1999).
8 Liverpool v. S.P.M. Environmental Inc., 592 N.Y.S. 2d 339 (1st Dept. 1993).
9 Greene v. Osterhoudt, 673 N.Y.S. 2d 272 (3rd Dept. 1998).
10 See, e.g., N.Y.S. Labor L. § 240(1).
11 See, e.g., Carlson v. Akin, 821 N.Y.S. 2d 671 (3rd Dept. 2006).
12 N.Y.S. Labor L. § 630.
13 See, e.g., In re Alpha Neurology P.C., 750 N.Y.S. 2d 139 (3rd Dep't 2002).
14 26 U.S.C. § 7201 et seq.
15 Greene, 673 N.Y.S. 2d at 274.
16 Id.
17 Carlson, 821 N.Y.S. 2d at 673.
18 Lisio v. Ranchos Realty of Corona Corp., 348 N.Y.S. 2d 574 (2nd Dept. 1973), modified by 36 N.Y.2d 739 (1975).
19 Liverpool, 592 N.Y.S. 2d at 340.
20 Carlson, 821 N.Y.S. 2d at 673.
21 Arculeo v. On-Site Sales & Marketing, LLC, 425 F.3d 193, 198 (2d Cir. 2005).
22 Id. See also, Nelson v. Beechwood Organization, 2004 WL 2978278 (S.D.N.Y. 2004).